No. 212.

Brf. of Blackburn & Hamilton

Appellee.

Supreme Court of the United States.

OCTOBER TERM, 1898.

Filed Jan. 23, 1899.

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THIRD STREET AND SUBURBAN RAILWAY COMPANY, APPELLANT,

against

MEYER LEWIS.

APPEAL FROM THE UNITED STATES CIRCUIT COURT OF APPEALS OF THE NINTH CIRCUIT.

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STATEMENT.

This cause comes here on an appeal from a decree of the United States circuit court of appeals for the ninth circuit, affirming an order of the circuit court for the district of Washington, northern division; which said order sustained the demurrer of the appellee to the amended answer of the appellants, and on which order a decree of foreclosure was entered. In his supplemental bill seeking foreclosure, the appellee sets up that on the 14th day of May, 1884, the West-

ern Mill Company, a corporation, made and delivered to the appellee its promissory note for twenty thousand dollars, payable three years after date, and to secure its payment executed a mortgage on certain lots in the city of Seattle; that the interest on said note and mortgage was paid to December 14, 1893, but not thereafter; that on October 14, 1891, the mortgagor sold and conveyed the property mortgaged to the Ranier Power and Railway Company, and that on or about the 13th day of June, 1893, in a cause pending in the circuit court of the United States for the district of Washington, brought by one A. P. Fuller, a receiver was appointed to take charge of the assets and affairs of said Ranier Power and Railway Company; that subsequently, on or about the 13th day of February, 1895, in the proceedings last mentioned and by order of the court, a deed for said mortgaged property was executed and delivered to parties who had purchased the same under a decree in said cause, and on the 12th day of February, 1895, the purchasers of said properties aforesaid conveyed the same to the Third Street and Suburban Railway Company, and that the interest of said Third Street and Suburban Railway Company was subject to the lien of the appellee's mortgage.

To this bill The Third Street and Suburban Railway Company, appellant, answered, alleging that the Ranier Power and Railway Company immediately, after receiving its conveyance of said lots from the mortgagor, applied said property to railway uses and erected thereon a power-house for its railway; that on June 13, 1893, a receiver was appointed to take charge of the assets and affairs of said railway company, and that said receiver, under order of the court, operated the railway properties and power-house, and on August 8, 1894, in pursuance of the instructions received from the court, issued receiver's certificates upon all of the property of said railway company, including the lands described in the bill; that it was adjudged by the court necessary and essential for the continued existence of the railway company,

as shown upon the receiver's petition, to issue these certificates, and that the order of the court made the certificates a first lien upon all of the property in the receiver's hands, including the mortgaged premises; that subsequently the certificate-holders, to enforce their lien, obtained an order for the sale of all the property in the receiver's hands, which sale was made on the 28th day of January, 1895; that upon the confirmation of this sale, on February 12, 1895, the purchasers of the property at such sale conveyed the same to the appellant, The Third Street and Suburban Railway Company. It is further alleged in the answer that the Ranier Power and Railway Company was a corporation organized with railway powers and owned public franchises for railway purposes; that the complainant did not seek to foreclose this mortgage at the time of the transfer of the land to the said corporation, but forebore to do so for more than two years, during which period the mortgage was overdue, but that he had accepted interest on the loan from said railway company, and also from the receiver; that the receiver before the announcement of the foreclosure suit paid taxes and insurance upon the land to the amount of about three thousand dollars; that although the complainant was not a party to the suit in which the receiver's certificates were issued, he had knowledge of that suit, and had accepted interest from the receiver with a knowledge of the litigation and of all of the facts set forth in the answer, and during the period of eleven months did not foreclose his mortgage and permitted the receiver with the trust funds to protect the mortgaged property. About three months before the issuance of the receiver's certificates, the complainant caused his appearance to be entered in said cause for the purpose of obtaining leave to sue the receiver, but did not ask to be made a party to the cause, nor did he serve notice of his appearance upon any of the parties; that he knew of the sale of the property under the receiver's certificates, but did not object or seek to disturb the same. To this answer a

demurrer was filed, which was sustained by the circuit court, and thereupon a decree of foreclosure was entered. From the order sustaining the demurrer an appeal was taken to the circuit court of appeals, which dismissed the appeal and affirmed the ruling of the court below. The decree of the circuit court of appeals is assigned as error on appeal to this court.

The particular grounds of error are specified in the appellant's brief on page 3, and in the discussion of these grounds two propositions are relied on: First, that the mortgage was wholly cut off by the certificates, and, second, that even if the mortgage was not cut off by the certificates, it yet must be charged with some of the expenses of the court. It is the contention of the appellee that neither of these propositions has any foundation in law. The positions now taken by the appellant and the arguments used in support thereof were taken and used in and before the circuit court of appeals, and they are fully considered and passed upon in the opinion of that court printed in the record and beginning on page 27.

ARGUMENT AND POINTS.

So fully have all of the material questions raised on the appeals from the order of the court sustaining the demurrer been discussed in the opinion of the circuit court of appeals that we might with propriety submit our case on that opinion, but to meet all possible objections we will very briefly discuss some of the more material points raised in the brief for appellant. The foundation of the contention of our adversaries is that the mortgage by the mill company to Meyer Lewis became by the subsequent sales of the property a railway mortgage, and, being thus converted into a railway mortgage, was subordinated to the lien of the certificates

under the decision of this court in the case of The Union Trust Company *vs.* The Railroad, 117 U. S., 434.

The primary error of the appellant is in assuming that the mortgage between individuals covering property in nowise connected with a railroad could by subsequent acts to which the mortgagee was not a party become a railway mortgage. When the appellee Lewis received his mortgage from the mill company, the rights and interests of Lewis became fixed, and no subsequent act on the part of the mill company could alter, vary, or lessen those rights. The after sale of the property to a railway company and the subjection of that property to railway uses could in nowise affect the interest of the appellee, and when the railway company went into the hands of the receiver the receiver, taking charge of the assets of the company, took only what the railroad had received from the mill company in the land in question.

It was not in the power of the mill company to disturb or to lessen the rights of the mortgagee; it was not in the power of that company to give to its grantee more than it possessed. The grantee really took in that property the right of the mill company to redeem, and when it became insolvent and went into the hands of the receiver, it only had in that property what it had obtained from the mill company, namely, its right to redeem, and when the receiver obtained from the circuit court authority to issue certificates and to make those certificates a first lien upon the property of the railway company, including the property purchased from the mill company, it obtained, so far as that property was concerned, the power only to make those certificates a first lien upon the right of the mill company to redeem that property from the mortgage of the appellee, and to that extent only could the court go, and its order making the certificates a first lien upon the property of the mill company must be read in that light.

But it is urged that the appellee had knowledge of this

order creating these certificates and of the sale of the property under that order, and that before such sale he had received interest from the receiver, and by the receipt of such interest had acquiesced in the transformation of this mortgage into a railroad mortgage. It is not contended in this connection that the appellee was ever, by any process of the court, made party to the suit wherein the receiver was appointed, or was ever brought by any decree or order of the court into a position where his rights and interests could be passed upon or bound by any decree in that suit.

The appellee's mortgage was a matter of record, and therefore notice to all of his first lien on the property. His rights were fixed and protected by law and could not be impaired—certainly not in a proceeding to which he was not a party. He had a right to assume that the action and proceedings of subsequent purchasers of the property were had and conducted with a full appreciation of his rights, and his knowledge of such proceedings carried with it no necessity for action on his part. He had a perfect right to receive from any number of subsequent holders by mesne conveyances the interest upon his mortgage, and the receipt of such interest did and could not, in the least degree, affect his lien. There was no obligation upon him to foreclose his mortgage immediately on the transfer of the property to the railway company; on the contrary, he had a right to forbear as long as the interest was paid, and it made not the slightest difference whether the interest was paid by the railway company or by the receivers.

As heretofore stated, the contention of the appellant is based upon the decision of this court in Trust Company *vs.* Railway Company, 117 U. S., 434; but in that case the court was dealing with railway mortgages, and the facts as to notice and other conditions of the case were entirely different from the case at bar, and these differences are very fully pointed out, and the inapplicability of the decision in that

case to the case at bar is very ably reasoned in the opinion of the circuit court of appeals (Record, p. 29).

There is absolutely nothing in this record showing the purposes for which the money realized from the sale of the certificates was used. In the Trust Company case a claim for $7,000—confessedly for the benefit of the trust—was disallowed, for the reason that "the purposes for which that sum was expended were not sufficiently shown."

The question of the priority of receiver's certificates and liens over existing mortgage liens has not very often been a matter of litigation, because in almost all instances in which the courts have authorized receivers to borrow money and make their obligation a first lien upon the property the mortgagees have themselves asked for the orders for this purpose in advance, or they expressly assented to the making of them, and, of course, they were in such cases precluded from afterwards claiming any priority over the lien thus created for the purpose of preserving the mortgaged property. But it is claimed that courts of equity have authority, without the consent of the mortgagees, to order the receivers to borrow money and to bind the property in their hands for the payment of liens. This authority, if it exists at all, is not, however, altogether discretionary; the judicial discretion is limited to settled principles of equity.

Jones on Railroad Securities, section 539.

The principle is clear that the mortgage cannot be displaced or postponed without the consent of the mortgagee. The court cannot by authorizing the receiver to create liens upon the property displace or impair the mortgagee's right of property any more than the legislature can impair the obligation of a contract. If such mortgagees are not parties to the suit in which the receiver was appointed they should be summoned in before the granting of any petition to charge the property with such debts. When prior mort-

gagees do not assent to receiver's liens these should be made expressly subject to the prior mortgages.

Jones on Railroad Securities, section 542.
Pennoyer *vs.* Neff, 95 U. S., 714.
Meyer *vs.* Johnson, 53 Ala., 237.

"The mortgagee has his strict rights which he may enforce in the ordinary way. If he asks no favors, he need grant none."

Fosdick *vs.* Schall, 99 U. S., 235.

And the power of courts to authorize receiver's certificates and to fix their status as to existing securities and the limitations upon that power are very fully discussed and stated in The Union Trust Company *vs.* The Midland Railroad Company, heretofore referred to.

See also Dunham *vs.* Railway Company, 1st Wallace, 254.
Fosdick *vs.* Schall, 99 U. S, 235.
Burnham *vs.* Bowen, 111 U. S., 780.

In the case of The T., D. & B. R. R. Co. *vs.* Hamilton, 134 U. S., 296, the question arose between a mortgagee and a party claiming a mechanic's lien upon the mortgaged premises as to the priority of payment. Mr. Justice Brewer, delivering the opinion of the court, says:

"It will be noticed, and it is a fact that lies at the foundation of this case, that the contracts for the construction of the docks were not made till more than three years after the execution and record of the mortgage. The record imparted notice to Hamilton, and all others, of the fact and terms of the mortgage; and the question is thus presented whether a railroad company, mortgagor, can, three years after creating by recorded mortgage an express lien upon its property, by contract with a third party displace the priority of the mortgage lien. It would seem that the question admits of but a single answer. Certainly as to ordi-

nary real estate, no one would have the hardihood to contend that it could be done. * * * By the mortgage the mortgagee took its vested priority beyond the power of the mortgagor or the legislature thereafter to disturb."

In Union Trust Co. *vs.* Morrison, 125 U. S., 591, the court say:

"In view of the discretion which the court of first instance is obliged to exercise in matters of that character taking all the circumstances into consideration, we cannot say that equitable relief was unduly extended in allowing the intervener's claim. * * * The ground of the claim is, that a portion of the property covered by the mortgage, being in peril of abstraction and loss, was rescued and saved to the mortgage by the act of the petitioner."

In Kneeland *vs.* American Loan and Trust Company, 136 U. S., 89, Mr. Justice Brewer, in speaking of the granting of preferences over the mortgage, says:

"The appointment of a receiver vests in the court no absolute control over the property and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver acquires power to give such preferences to any general and unsecured claims. It has been assumed that a court appointing a receiver could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. Indeed, we are advised that some courts have made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgage liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot. So, when a court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the rulings of

this court, have been declared to have an equitable priority. No one is bound to sell to a railroad company or to work for it, and whoever has dealings with a company whose property is mortgaged, must be assumed to have dealt with it on the faith of its personal responsibility, and not in expectation of subsequently displacing the priority of mortgage liens. It is the exception, and not the rule, that such priority of liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens."

In the case of Kneeland *vs.* Luce, 141 U. S., 508 (Appellant's Brief, p. 17), the consent of the trustees, and thus of the bondholders, was given to the issue of the receiver's certificates.

And in Wood *vs.* New York and New England Railroad Company, 70 Fed. Rep., 741, it is said that—

"The tendency of judicial decisions is to narrow rather than enlarge the class of claims against railroad companies to be preferred over mortgage liens out of funds in the hands of receivers."

The appellant's brief, in large part, is devoted to the discussion of the proposition that, even though the certificates are subordinate to the mortgage, the mortgage must bear some share of the court's expenses incurred by the receiver in payment of interest upon the mortgage and of taxes and repairs on the property mortgaged; in other words, that the holder of an ordinary mortgage on property subsequently conveyed to the purchaser, who afterwards became insolvent, but who before his insolvency had improved the property and paid interest upon the mortgage, is to be charged with the repayment of interest so paid and with the taxes and repairs on improvements made for the benefit of said subsequent purchaser.

It was held in Wood *vs.* Guarantee Trust Company, 128

U. S., 416, that the unsecured creditors of a water company were not entitled to any special priority, and that such priority would not be accorded except in the case of a railroad company.

It has also been decided that the doctrine of preferential debts has no application to a company which is a common carrier by water.

Bound *vs.* South Carolina R. R., 50 Fed. Rep., 312.

"Extensive as are the powers of courts of equity they do not authorize the chancellor to thus impair the force of solemn obligations and destroy vested rights. Instead of displacing mortgages and other vested liens upon the property of private corporations and natural persons it is the duty of courts to uphold and enforce them against all subsequent incumbrances. It would be dangerous to extend the power which has been recently exercised over railroad mortgages (sometimes with unwarranted freedom) on account of their peculiar nature, to all mortgages."

Farmers' L. & T. Co. *vs.* Grape Creek Coal Co., 50 Fed. Rep., 481.

If the order of sale makes no mention of prior liens or encumbrances of any kind, the sale passes the title to the property as it is in the receiver and subject to whatever encumbrances or liens there may be existing upon it. It has been held that the lien of a mortgage given by a firm to one who was not a party to the action subsequently brought, in which a receiver was appointed over its affairs, cannot be divested by a sale of the mortgaged property made by the receiver by authority of the court.

Lorch *vs.* Aultman, 75 Ind., 162.

The appellee forfeited no right by failure to foreclose his mortgage between the 14th day of December, 1893, to which date the interest was paid, and the 8th day of May, 1894, when he filed his petition in the circuit court of the United States asking leave to sue the receiver. A mortgagee who

fails to take action upon default in the payment of interest on the mortgage debt does not by such failure make the mortgagor his agent to incur debts, nor does he impliedly consent that debts incurred subsequent to the default shall take precedence over the mortgage debt.

Blair *vs.* St. L., H. & K. R. R., 22 Fed. Rep., 471.

There was no obligation upon the receiver to pay the interest or taxes upon this property, unless it was to preserve the property subject to the appellee's mortgage. The receiver could have defaulted in interest, and thereby compelled an earlier foreclosure. The receiver might have failed to pay taxes, and the unpaid taxes would have been a charge upon the property at the time of foreclosure, and if the receiver made repairs, it was to preserve not the rights of the mortgagee, but the contingent rights of the railway company and the receivership.

The mortgagor is not entitled to a credit on the mortgage debt for taxes paid by him.

Kilpatrick *vs.* Henson (Ala.), 1 So. Rep., 183.
Newton *vs.* Marshall, 62 Wis., 8.
Beltram *vs.* Villeré (La.), 4 So. Rep., 506.

This contention of the appellant is so fully disposed of by the opinion of the circuit court of appeals that we will dismiss the question with a quotation from that opinion. On page 31 the court says:

"The appellant insists that there is ground for the equitable preferment of the receiver's certificates over the complainant's liens in the fact that the receiver, before the commencement of this foreclosure suit, paid out of the assets of said railway company for insurance and taxes on the mortgaged property the sum of $3,000, thereby reducing the assets of the company and in part creating the necessity for the issuance of the certificates. We are unable to see how this contention can be sustained. If the receiver paid taxes and insurance, it was in the discharge of his duty and

in the course of business and for the purpose of protecting the property as it was, and, possibly, for the purpose of averting a suit by the complainant to foreclose his mortgage. The greater portion of the sum so paid is evidently on account of the improvements placed upon the property by the railway company and not for taxes upon the lots which were the subject of the complainant's mortgage. If the taxes had remained unpaid, they would now be an additional charge upon the real estate, and the complainant in his decree of foreclosure would be entitled to have that amount also paid out of the security. The mortgage contemplated this, and it is not shown that the value of the property is inadequate to meet such increased charge upon it."

It is respectfully submitted that the decree of the circuit court of appeals should be affirmed.

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